THOUGHTS FOR THE WEEK

COME TOGETHER

May 16, 2025

He say, "One and one and one is three"
Got to be good-lookin' 'cause he's so hard to see
- *Come Together*, The Beatles

Deep within the Amazon lives the Pirahã, a tribe of eight hundred peaceful indigenous people. Their isolated lifestyles are uniquely free of Western concepts like private property and social hierarchy. They hunt, gather, and trap when they are hungry, as opposed to storing resources for future consumption. They do not maintain written or oral historical records, and they do not have a well-defined counting system. Instead, they have words for “one” and “two,” but anything in excess of “two” is just “many.”

Said another way, the Pirahã translation of *Come Together* is “One and one and one is…*many*.”

Color us biased, but it is difficult to imagine a life without numbers. Say goodbye to 21st century technology, modern medicine, and, of course, the capital markets. Though…there have been times this year where investors would have preferred **not** to have a well-defined counting system to tally up their daily losses. We digress.

During periods of volatility, clients often ask, “What’s the stock market going to do next?” Our answer is always a confident, “We don’t know, and we don’t think anyone knows.” However, we caveat that response with a reassuring reminder that painful short-term volatility is often the price patient investors “pay” for attractive long-term returns.

Said another way, the long-term returns are often *good lookin’*, but in times of market duress, they can be *hard to see*. (Adding the usual disclaimer: past performance is not indicative of the future)

Understanding what drives stock market returns can help investors get more comfortable with our long-term perspective. The following three factors explain the stock market performance over any period in time:

1. Dividend yield
2. Changes to the PE ratio
3. Earnings growth

<u>Dividend Yield</u>

The dividend yield represents the cash return investors receive from owning stocks. For example, if you bought a share of the S&P 500 at the beginning of this year for $5,900, and you received $75 of dividends over the following 12 months, your dividend yield would be 1.27% ($75 divided by $5,900). Dividends tend to be fairly stable for large publicly traded companies. A McKinsey study notes that in a typical year, fewer than 2% of companies reduce dividends. However, rates of dividend cuts increase during times of market stress like the Great Financial Crisis (5%) and the Covid-19 Pandemic (15%).

<u>Change to the PE Ratio</u>

Investors often price stocks as a multiple of the earnings they generate, similar to the way home buyers may consider a property's price per square foot. This helps compare prices on a *relative* basis. For example, if the S&P 500 trades at 5,000 and generates $250 of earnings, it trades at price earnings multiple of 20x. All things equal, a lower multiple (like a lower price per square foot) implies a better value for investors. The multiple can change for several reasons – economic outlook, interest rate environment, growth projections, etc – rising when confidence is high and contracting when sentiment sours.

<u>Earnings Growth</u>

The value of the stock market is defined by the earnings that its underlying businesses generate. Per the prior paragraph, investors pay a multiple of earnings for stocks, and as earnings increase, the price of the stock market should, all things equal, rise in tandem. While the multiple investors assign to earnings is a subjective expression of what they *think* stocks are worth, earnings are an objective, quantifiable assessment of value. Multiples will rise and fall in any given year, but earnings can continue to compound for decades.

The historical data *come together* to evidence an important lesson. Sentiment may drive price changes over short periods of time, but long-term stock market returns are driven by the underlying businesses, through a growing stream of earnings and dividends.

From 1973 to 2023, the Stock Market rose on average 12.5% per year:

- 3.0% came from dividends.
- 1.4% came from an expansion of the price earnings multiple.
- 8.1% came from the growth in earnings.

  (Source: NYU Stern)

In sum, dissecting the stock market's return drivers helps us focus less on what may happen over *one* or *two* quarters, and more on what will likely happen over *many* years.

Enjoy your reading and your weekend.

The Burbank Group
Mike, Cate, Scott, Willis, Suzy, Oscar and Wes

<u>Private Wealth Advisors:</u>

PRIVATE WEALTH MANAGEMENT

Morgan Stanley

Mike Burbank, CIMA®, CFP® Managing Director
Scott Hafeli, CFA Executive Director
Willis Davis, CFA Senior Vice President

Cate Rachford Senior Vice President, Group Director
Suzy Shin Associate Vice President, Wealth Management Associate
Oscar Castillo Portfolio Associate
Wes Cai Wealth Management Analyst

Morgan Stanley Private Wealth Management | The Burbank Group
555 California Street, 14th Floor | San Francisco, CA 94104
Phone: +1 415 576 3134

To unsubscribe from the email list, please contact Wes Cai at Wes.Cai@morganstanleypwm.com.

Awards:
2024 Barron's Top 250 Private Wealth Management Teams
Source: barrons.com (Awarded May 2024) Data compiled by Barron's for the period Jan 2023-Dec 2023.

2024 Forbes Best-In-State Wealth Management Teams
Source: Forbes.com (Awarded Jan 2024) Data compiled by SHOOK Research LLC based on time period from 3/31/22-3/31/23.

Mike Burbank | **2020 & 2022-2024 Forbes Best-In-State Wealth Advisors**
Source: Forbes.com (Awarded 2020 & 2022-2024). Data compiled by SHOOK Research LLC based 12-month time period concluding in June of year prior to the issuance of the award.

Mike Burbank | **2017-2024 Barron's Top 1,200 Financial Advisors: State-by-State** (formerly referred to as Barron's Top 1,000 Financial Advisors: State-by-State)
Source: Barrons.com (Awarded 2017-2024). Data compiled by Barron's based on 12-month period concluding in Sept of the year prior to the issuance of the award.
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